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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

July 8, 1999

Ex Parte

Ms. Magalie R. Salas
Secretary
Federal Communication Commission
Room TW-A325, The Portals
445 Twelfth Street
Washington, D.C. 20554

Re: CC Docket No. 98-137, In the Matter of 1998 Biennial Review—Review of
Depreciation Requirements for Incumbent Local Exchange Carriers

ASD Docket No. 98-91, USTA Petition For Forbearance from Depreciation
Regulation

CC Docket No. 98-177, In the Matter of 1998 Biennial Regulatory Review—
Petition for Section 11 Biennial Review filed by SBC Communications Inc.,
Southwestern Bell Telephone Company, Pacific Bell and Nevada Bell

CC Docket No. 98-45, Universal Service

Dear Ms. Salas:

In accordance with the Commission's rules, please be advised that on July 8, 1999, the attached written ex parte was provided by SBC Communications Inc. (SBC) to Mr. Lawrence Strickling, Chief of the Common Carrier Bureau. SBC urges FCC to grant the Petition filed by USTA to forbear from regulating depreciation lives and rates. With forbearance Local Exchange Carriers (LECs) will use the same lives based upon Generally Accepted Accounting Principles ("GAAP") for both FCC reporting purposes and external reporting GAAP purposes.

An original and two copies of this letter and the attachments are being submitted. Acknowledgement and date of receipt of this transmittal are requested. A duplicate transmittal letter is attached for this purpose.

Please include this letter in the record of these proceedings in accordance with Section 1.1206(a)(2) of the Commission's Rules.

If you have any questions on this, please do not hesitate to contact me at 202-326-8894.

Sincerely,

A handwritten signature in black ink, appearing to read "B. Jeannie Fry". The signature is written in a cursive, somewhat stylized font. The first letter "B" is large and prominent. The last letter "y" has a long, thin tail that extends downwards.

B. Jeannie Fry
Director—Federal Regulatory

Attachments



Marian Dyer
Vice President-Federal Regulatory

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Phone 202 326-8835
Fax 202 408-4805

July 8, 1999

Mr. Larry Strickling
Chief Common Carrier Bureau
Federal Communication Commission
Room 5-C450, The Portals
445 Twelfth Street
Washington, D.C. 20554

Re: CC Docket No. 98-137, In the Matter of 1998 Biennial Review—Review of
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Petition for Section 11 Biennial Review filed by SBC Communications Inc.,
Southwestern Bell Telephone Company, Pacific Bell and Nevada Bell

CC Docket No. 96-45, Universal Service

Dear Mr. Strickling:

As a follow up to our May 18, 1998 Ex Parte meeting with you and members of your staff, SBC Communications Inc. (SBC) takes this opportunity to emphasize the importance for the Commission to reform, in a timely manner, the current way in which it regulates depreciation.

SBC asks the FCC to allow carriers to use Generally Accepted Accounting Principles (GAAP) to set depreciation lives and rates for financial reporting purposes, whereby carriers would use the *same* depreciation rates and lives for regulatory reporting and external financial reporting. As such, this would afford carriers the opportunity to establish depreciation rates and lives based upon forward looking capital recovery techniques. This would also eliminate the burden of two separate and costly capital recovery systems which carriers maintain today to report information to comply with the Commission's Part 32 rules and to report information to the Securities and Exchange Commission (SEC) that complies with GAAP.

True economic forward looking capital recovery techniques use the change in technology and the rate of change of technology as a foundation for establishing depreciation lives and rates. On the other hand, the FCC's current form of depreciation regulation and prescription are not founded upon these economic forward looking concepts but on a backward looking methodology, where lives and rates are prescribed based upon the historical retirement trends and information. Thus, changes in technology, triggered by competition or mandated by the Commission's Orders, are only considered as an after thought in the current FCC prescription process. More and more, the past should not continue to be the predominate predictor of future technology lives in view of the rapid change in technology experienced by this industry.

In fact, the FCC's current depreciation life conventions, used for UNE pricing and Universal Service, are largely based upon the FCC prescribed ranges determined in the Second Depreciation Simplification Order.¹ Unfortunately, these ranges are not only outdated but were constructed based upon prescribed lives available in the 1991-1993 time period predicated on backward-looking retirement data. Thus, the ranges employed today are based on grossly out-dated information, which do not conform to the concept of forward looking costs. The current NPRM does not extensively address the change needed to advance the ball with respect to the current situation by changing the range allowed for only one of the plant accounts.

In addition, if carriers were allowed to employ lives based upon the principles of GAAP, regulatory jurisdictional financial reporting would be more representative of the actual rate of capital recovery. GAAP mandates a determination of lives based upon the most current and representative view of the expected lives of assets. Such lives are synonymous with the forward looking concepts of UNE pricing and Universal Service costing. In other words, if the Commission chooses forward looking methods in its models for cost determination of UNE services and Universal Service distribution, then it is only appropriate that the methods used in these models for capital recovery, in fact, match and be consistent with these forward looking concepts.

SBC asks that the FCC grant USTA's Petition for Forbearance. With forbearance Local Exchange Carriers will use the same GAAP lives and rates for both FCC reporting purposes and external reporting purposes. Many states already recognize that depreciation reviews and approvals are largely unnecessary and several states have adopted GAAP for depreciation.² As the California Public Service Commission noted:

"We not only suspend, however, but permanently eliminate depreciation reviews and approvals. Depreciation reviews and approvals treat Pacific and GTE

¹ Universal Service Order, 12 FCC Rcd at 8913-14, para 250.

² For example, states that allow LECs to use GAAP depreciation methods for regulatory purposes include: Alabama, Arkansas, California, Florida, Idaho, Michigan, Missouri, North Carolina, North Dakota, Oklahoma, Pennsylvania, South Dakota, Texas, Wisconsin and Wyoming. See Supplement to July 15, 1998 Position Paper, "Accounting Simplification in the Telecommunications Industry," Prepared by Arthur Andersen LLP, November 10, 1998, Page 17.

Mr. Larry Strickling
July 8, 1999
Page 3

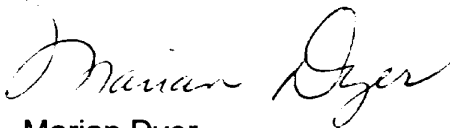
asymmetrically compared to their competitors. We agree with Pacific that the lack of competitive neutrality in depreciation regulation harms competition, consumers and incumbent firms. The harm results from possible negative effects on investment decisions, leaving consumers with higher prices and fewer services. The negative influence occurs when investment decisions are skewed by regulated depreciation rates (if not equivalent to market depreciation rates) used in economic analyses for some firms but not others. We also agree with GTE that this asymmetry subjects GTE and Pacific to administrative costs not required of CLCs, and is needless with the suspension of sharing. Thus, our concern about competitive neutrality, and desire to level the playing field whenever possible, persuades us to permanently eliminate depreciation reviews and approvals."³

SBC urges the Commission to allow carriers to make use of these forward looking GAAP depreciation lives, such that the lives and rates used for external reporting match those used for regulatory reporting. As discussed in our May 18, 1999 meeting with you and your staff, granting carriers this ability in no way mandates the manner in which states set UNE pricing. However, the Commission could simultaneously elect to set forth principles in its order(s), in the CC Docket No. 98-137 and related proceedings, addressing the use of forward looking lives for purposes of depreciation rate making, Universal Service reporting and UNE cost determination. Such principles should, at a minimum, include the following:

- Depreciation rates and lives used for regulatory financial reporting purposes shall match those used for externally reporting GAAP purposes;
- Depreciation rates and lives shall be based upon forward looking economic methods which consider technological change and the rate of technological change.⁴

If you would like to further discuss this matter, please do not hesitate to contact me or Jeannie Fry at 202.326.8894.

Sincerely,



Marian Dyer
Managing Director—Federal Regulatory

³ Rulemaking on the Commission's Own Motion into the Third Triennial Review of the Regulatory Framework Adopted in Decision 89-10-031 for GTE California Incorporated and Pacific Bell, R.98-03-040, Decision October 8, 1998, Page 52.

⁴ Note that methods do exist which can be utilized to confirm the reasonableness of a carrier's forward looking lives. Industry literature such as that published by Technology Future Inc as well as a simple comparison of the various IXCs', CLECs', and large cable companies' capital recovery lives can be used to confirm the reasonableness of the rates and lives chosen by LECs for depreciation.

Cc: Chairman William Kennard
Commissioner Susan Ness
Commissioner Gloria Tristani
Commissioner Harold Furchtgott-Roth
Commissioner Michael Powell
Mr. Ken Moran, Chief, Accounting Safeguards Division
Mr. Tim Peterson, Deputy Chief, Accounting Safeguards Division
Mr. Thom David, Accounting Safeguards Division
Mr. Howard Shelanski, Chief Economist, Office of Plans and Policy
Mr. Pat DeGraba, Office of Plans and Policy
Ms. Jane Jackson, Chief, Competitive Pricing Division
Mr. Jay Atkinson, Competitive Pricing Division
Mr. Doug Slotten, Competitive Pricing Division
Ms. Lisa Zaina, Deputy Bureau Chief, Common Carrier Bureau
Mr. Bill Bailey, Counsel, Common Carrier Bureau,
Mr. Don Stockdale, Common Carrier Bureau
Mr. Bob Loube, Economist, Accounting Policy Division
Mr. Craig Brown, Deputy Chief, Accounting Policy Division